Supreme Court, U.S.
FILED
NOV 14 1996
OFFICE OF THE CLERK

No. 96-584

In The
SUPREME COURT OF THE UNITED STATES
October Term, 1996

DOUGLAS R. PRINCE and JANE PRINCE,
Petitioners,
v.
UNSECURED CREDITORS COMMITTEE,
Respondent.

Petition For Writ of Certiorari
To The United States Court of Appeals
For The Seventh Circuit

RESPONSE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Daniel A. Zazove
Counsel of Record
20 North Clark Street, Suite 1000
Chicago, Illinois 60602
(312) 641-1155

Of Counsel:
Barbara L. Yong
Peter J. Butler
Barbakoff Zazove & Glick Chartered
20 North Clark Street, Suite 1000
Chicago, Illinois 60602
(312) 641-1155

41 pp

QUESTION PRESENTED

Whether a business is properly valued on a going concern basis, rather than a liquidation basis, where the debtor's Chapter 11 Plan contemplates the debtor's retention of equity in the business and where the debtor intends to continue to operate the business?

TABLE OF CONTENTS

INTRODUCTION 1

STATEMENT OF THE CASE 1

REASONS FOR DENYING THE WRIT 7

I. THE DECISIONS BELOW CORRECTLY VALUED THE STOCK ON A GOING-FORWARD, RATHER THAN LIQUIDATION, BASIS. 7

II. THE PETITIONERS HAVE FAILED TO CORRECTLY FRAME THE ISSUE IN THIS CASE AND, THUS, HAVE FAILED TO OFFER A COGENT REASON FOR THE GRANTING OF A WRIT OF CERTIORARI. 11

CONCLUSION 15

TABLE OF AUTHORITIES

CASES

Butner v. United States, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed. 2d 136 (1979) 10

In re Andrews, 80 F.3d 906, 911-12 (4th Cir. 1996) 13

In re Marriage of Zells, 143 Ill. 2d 251, 254, 572 N.E.2d 944, 946 (1991) 14

In re Winthrop Old Farm Nurseries, 50 F.3d 72, 76 (1st Cir. 1995) 10

RULES, STATUTES & MISCELLANEOUS

11 U.S.C. §506(a) 8

Richard A. Brealey & Stewart C. Myers, Principles of Corporate Finance 29-68 (4th ed. 1991) 8

Supreme Court Rule 14.1(a) 7

Supreme Court Rule 14.4 5

Supreme Court Rule 14(h)(i) 4

STATUTE INVOLVED

An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to set off under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to set off, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. §506(a)

INTRODUCTION

There is nothing presented by the Petition which makes this case appropriate for review. This case presents one issue: whether the stock in a professional corporation is properly valued as a going concern where a Chapter 11 Debtor retains the equity and intends to continue to operate the business. That question is conclusively answered by the Bankruptcy Code which values property in light of the purpose of the valuation and the proposed use of such property. The Bankruptcy Court, affirmed by the District Court and the Seventh Circuit, correctly applied this standard of valuation and, hence, there is no reason for review of either the appropriate standard of valuation or the application of that standard. The questions raised by the Petitioners as to ownership of covenants not to compete and goodwill are neither pertinent nor apposite to the dispute between the parties and are not properly issues before this Court.

STATEMENT OF THE CASE

On August 17, 1981, Petitioners, Douglas R. and Jane Prince (the "Princes" or "Debtors"), as husband and wife, filed their joint petition for relief under Chapter 11 of the Bankruptcy Code. (Petitioner's Appendix ("App.") at A-2) At the date of filing the bankruptcy petition, Douglas R. Prince ("Dr. Prince") was the owner of 100% of the issued and outstanding stock of a professional orthodontic practice (the "Professional Practice" or "Practice"). (Id.) Eventually, the Debtors filed a series of amended disclosure statements and plans dated October 20, 1982, November 8, 1982, and February 10, 1983. (Id.) The Amended Disclosure Statement and Plan dated February 10, 1983 (the

"Amended Plan") was ultimately confirmed on November 4, 1983. (Id.)

The Amended Plan provides, inter alia, that Dr. Prince would retain the stock of the professional corporation and continue to operate the Professional Practice. (Id.) In consideration for retaining the stock, Dr. Prince agreed to pay its value to the bankruptcy estate for distribution to creditors. (Id.) The Debtors represented in the Plan that the value of the Professional Practice was only $7,500.00. The Respondent herein, the Official Committee of Unsecured Creditors (the "Committee"), refused to accept the Debtor's valuation of the Corporation's stock. However, as a result of Debtors' negotiations with the Committee, the Plan also provides that in the event Dr. Prince and the Committee are unable to reach an agreement on the value of the Practice, that the valuation dispute would be resolved by the Bankruptcy Court. (Id.)

On February 25, 1984, Dr. Prince and another orthodontist, Dr. Timothy J. Clare ("Dr. Clare") of Orchard Park, New York, executed an agreement for the purchase and sale of the Professional Practice ("Practice Sales Contract"), inclusive of its going concern value, for a price of $450,000 or $500,000, depending on the interest rate used. (Id. at A-3) Subsequent to the signing of the Practice Sales Contract, Dr. Prince and Dr. Clare had a falling out and the contemplated sale was never consummated. (Id. at A-4)

Dr. Prince and the Committee were never able to agree on the value for the Professional Practice. (Id. at A-3) In accordance with the Amended Plan, they submitted the valuation issue for trial before the Bankruptcy Court. (Id.)

The Committee's expert witness testified that the value of the stock in November of 1983 was approximately $650,000. (Id. at A-4) The Committee's expert based his opinion upon the capitalization of cash flows that the Practice was likely to produce in the future. (Id.) The Debtor had acknowledged that the Practice had generated an annual income of between $250,000 and $300,000 annually for the Debtor. (Id.) The Committee's expert conceded that this value would not exist if the Debtor were to leave and compete with the corporation. (Id.)

Debtors' expert testified that the value of the stock of the corporation was equal to the hard assets of the practice which included the equipment and supplies. (Id.) His valuation did not include goodwill based on the absence of a restrictive covenant. The Debtor's expert did acknowledge, however, that vast majority of the practices that are sold include a restrictive covenant. (Id.)

Following the hearing, the Bankruptcy Court determined, as a matter of law, that the value of the Professional Practice was $7,500.00, exclusive of goodwill, based on the net liquidation value of the tangible assets of the Practice. (Id. at A-5) The Committee appealed the Bankruptcy Court's initial valuation determination of the Practice to the United States District Court. On April 12, 1993, District Judge John F. Grady reversed the Bankruptcy Court's decision insofar as it excluded goodwill from the valuation of the stock and remanded the case for a determination of the value of the stock with goodwill included and with consideration of the Practice Sales Contract. (Id.) The District Court found that the arm's-length sale agreement between Dr. Prince and Dr. Clare to be an accurate proxy for the value of the stock. (Id.)

On October 21, 1993, the Bankruptcy Court reopened the trial on the valuation of the Professional Practice. (Id.) At the conclusion of the hearing on October 21, 1993, the Bankruptcy Court determined that the $450,000 purchase price under the Practice Sales Contract would be reduced by the value of Dr. Prince's services due under the contract for services rendered during a "transition" period, as well as salary, housing, transportation, fuel and insurance for Dr. Clare during the same "transition" period. (Id. at A-6) Also, based upon Dr. Prince's testimony that Dr. Clare received the income from the Practice during the "transition" period, the Bankruptcy Court reduced the purchase price by a correlative amount. (Id.) Subtracting these various deductions from the price due under the Practice Sales Contract, the Bankruptcy Court set the net value of the practice at $292,290.00. (Id.) Within 10 days of the entry of judgment, the Committee moved under Fed. R. Civ. P. 59(e) to alter the judgment announced by the Bankruptcy Court asking the court to reconsider, or take additional evidence on, the various reductions it made in arriving at the value of the Practice, particularly regarding whether Dr. Prince or Dr. Clare received the income from the Practice during the "transition" period. The Bankruptcy Court found it "undisputed" that Dr. Prince and not Dr. Clare received the income of the Professional Practice for the months of February, March, April, May and June of 1984, after which time neither Dr. Prince nor Dr. Clare continued to operate the Practice. (Id. at A-7) The Bankruptcy Court then adjusted its previous deductions and arrived at a valuation of the Professional Practice of $405,440.00, inclusive of good will, and entered a final order. (Id.)[1]

---

[1]This is the final order from which the Petitioners are actually appealing. In contravention of Supreme Court Rule 14(h)(i), the Petitioners have failed to include both the Bankruptcy Court's Final

The Princes appealed this final order to the United States District Court contending that the Bankruptcy Court abused its discretion in granting the Committee's Motion to Alter Judgment under Rule 59 of the Federal Rules of Civil Procedure. (Id. at A-7) District Court Judge Suzanne B. Conlon affirmed the Bankruptcy Court's order, finding that the Bankruptcy Court had not abused its discretion in reopening the proofs and amending its judgment in order to prevent injustice, correct a manifest error of fact, and correct a judgment based on Dr. Prince's "false testimony". (Supp. App. at 9.)

The Princes filed separate appeals from both District Court Judge Conlon's decision affirming the Bankruptcy Court's order granting the Committee's Motion to Alter Judgment and District Court Judge Grady's decision remanding the case back to the Bankruptcy Court for a determination of the value of the stock including goodwill. The two appeals were consolidated for hearing and decision before the United States Court of Appeals for the Seventh Circuit.

The Court of Appeals affirmed both decisions of the District Court. First, the Court of Appeals held that proper valuation of stock as an asset is determined by "its ability to generate cash flows in the future." (App. at A-8) The Court determined that, in the absence of guidance from the

---

Order and the District Court's Memorandum Opinion and Order dated September 1, 1994 affirming that Order, as part of their Appendix. Parenthetically, the Committee notes that the failure to include the order appealed from in and of itself is sufficient reason for the Court to deny the Petition. See Supreme Court Rule 14.4. To assist the Court in a full understanding of the proceedings below, copies of these two orders are attached hereto as a Supplemental Appendix (hereinafter "Supp. App.").

parties, goodwill should be included in the valuation of stock. (Id. at A-7) This analysis is changed when the business in question is to be liquidated, rather than continued as an ongoing concern. In the former case, liquidation value is appropriate; in the latter, goodwill is to be included as part of the business' future anticipated income stream:

> In dissolution, liquidation distributions are the only foreseeable future cash flows to the shareholder, and thus liquidation value is an accurate tool for measuring the stock's value. On the other hand, where a business is expected to continue as a going concern, the company's expected future earnings from operations often far exceed the liquidation value of the company's physical assets. Thus, when valuing a business that is continuing to operate as a going concern, liquidation value is generally an inaccurate approximation of what shares are worth to the shareholders.

(Id. at A-11 (citations omitted)) It is undisputed that the Debtors were planning to continue operating the Practice at the time the Amended Plan was approved. Finding that the factual consequences hinging upon whether goodwill is treated as part of the value of the stock were undisputed, the Court of Appeals affirmed the decisions of the District Court and the Bankruptcy Court as to the value of the stock.

Second, the Court of Appeals affirmed the District Court's finding that the Bankruptcy Court properly exercised its discretion in granting the Committee's Rule 59(e) motion to alter or amend the judgment. (Id. at A-18 - A-21) The Petitioners have not taken exception to the Court of Appeals'

decision as to this issue and, accordingly, it has been waived. Supreme Court Rule 14.1(a).

REASONS FOR DENYING THE WRIT

I. THE DECISIONS BELOW CORRECTLY VALUED THE STOCK ON A GOING-FORWARD, RATHER THAN LIQUIDATION, BASIS.

Respondent respectfully opposes the Petition for Writ of Certiorari, which, as the old saying goes, would "confuse a riot." The Petition seeks review of two issues which have no bearing on the ultimate disposition of this case--whether a bankruptcy estate owns the goodwill and covenants not-to-compete of a bankrupt professional. Rather, the sole issue presented below was the proper valuation of stock in the debtor's hands at the time of the filing of the bankruptcy petition where the debtor intended to retain the equity and continue operating the corporation. Such valuation must, of course, be made on a going-forward basis rather than a liquidation basis in light of the Debtor's plans to continue operating the business after confirmation.

This is the analysis the Seventh Circuit affirmed below and is consistent with the Bankruptcy Code's approach to valuation of property:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to set off under

> section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to set off, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. §506(a)(emphasis added). The legislative history of §506(a) indicates that when valuing property, "Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interests in the case." H.R. Rep. No. 95-595 at 356, 5 U.S. Code Cong. & Admin. News at 6312. Valuation of property under the Bankruptcy Code must, therefore, focus on (1) the purpose for which the valuation is being a performed and (2) the proposed disposition or use of the property. These two factors are to be weighed on a case-by-case basis. Id.

Respondent readily acknowledges that §506(a) was intended to determine the extent to which a specific creditor is secured or unsecured during a bankruptcy case, an issue currently not before the Court. However, the approach taken by the Bankruptcy Code to valuation is consistent both with the approach to valuation taken in other, non-bankruptcy contexts and with the approach to stock valuation taken by the Seventh Circuit in the decision below. (See App. at A-8 (wherein the Seventh Circuit cited Richard A.

Brealey & Stewart C. Myers, Principles of Corporate Finance 29-68 (4th ed. 1991)) Thus, the Seventh Circuit succinctly set forth the Bankruptcy Court's duties in valuing the Petitioners' stock in this case:

> The bankruptcy court's task was not to determine the present value of the stock as of some hypothetical future day when Dr. Prince left to compete with his own corporation, but to determine the value of the stock on the day the bankruptcy reorganization plan was confirmed. Present value is derived by discounting back a projected stream of future cash flows, and this stream of cash flow projects is based on the probability of possible future events.

(App. at A-11 - A-12)(emphasis added) Happily for the Bankruptcy Court, the discounting of the "projected stream of future cash flows" had already been performed by the Petitioners when they had agreed to sell the Professional Practice to Dr. Clare.

The facts of this case demonstrate why the Seventh Circuit correctly applied the going concern method of valuation, rather than valuing the stock on a liquidation basis. The Petitioners agreed in the Amended Plan, confirmed November 4, 1983, to pay the **value** of the stock to the bankruptcy estate in return for the right to continue to operate the Professional Practice. Prince did continue to operate the business and, less than four months later, attempted to sell the practice for at least $450,000. As all three courts below found, the stock of the practice was worth approximately $450,000 at the time the Amended Plan was confirmed, since that is the amount that a ready, willing and

able buyer was willing to pay for the Professional Practice. In any event, the undisputed facts demonstrate that the Professional Practice was worth far more than the $7,500 the Debtors proposed to pay to the bankruptcy estate.

In similar circumstances, other courts have refused to allow debtors to assign a low value to their assets when dealing with creditors and then aggregate to themselves a substantially higher fair market value for the same assets when dealing with third parties:

> The interpretation championed by [the debtor] renders the second sentence of §506(a) virtually meaningless. Moreover, it would allow a reorganizing debtor to reap a windfall by stripping down the lien to liquidation value and quickly selling the collateral at fair market value, thus pocketing equity that would have been completely beyond reach save for the filing of the bankruptcy petition. Cf. Butner v. United States, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed. 2d 136 (1979)(bankruptcy law should "prevent a party from receiving a windfall merely by reason of happenstance of bankruptcy").

In re Winthrop Old Farm Nurseries, 50 F.3d 72, 76 (1st Cir. 1995). The Princes have offered no reason as to why their stock should be given a higher value to everyone except their creditors. In fact, none exists. Id.[2]

---

[2]Indeed, the facts would indicate that the Princes believed that the result they wished to achieve would be inequitable vis-a-vis the Committee, since the Princes conspired to keep the impending sale of the Practice to Dr. Clare a secret from the Committee. (Supp.App. at 1-2)

In sum, the Seventh Circuit, the District Court and the Bankruptcy Court correctly valued the stock as a going concern. This was the only question that was presented below. Moreover, the method of valuation was neither unique nor remarkable. In fact, the method used was entirely consistent with the approach taken elsewhere in the Bankruptcy Code and by courts interpreting the Code. The Committee notes that the Petitioners have failed to cite any authority for the proposition that the method used for valuation of the stock was inappropriate. Plainly, there is nothing presented by this case which would warrant this Court's review.

II. THE PETITIONERS HAVE FAILED TO CORRECTLY FRAME THE ISSUE IN THIS CASE AND, THUS, HAVE FAILED TO OFFER A COGENT REASON FOR THE GRANTING OF A WRIT OF CERTIORARI.

At bottom, the Petitioners are attempting to divert this Court's attention away from the real issue in the case in order to create a controversy where none exists. As is demonstrated above, the issue in this case is the proper valuation of stock in a professional corporation where the debtor intends to continue to operate the corporation. Rather than addressing this issue, the Petitioners frame the issue differently, claiming that the question posed is whether a bankruptcy estate "owns" the professional goodwill of (or, put differently, possesses an implied covenant not-to-compete from) the debtor. The Petitioners further assert that there is a split among the circuits on this issue.

Unfortunately for the Petitioners, this issue is irrelevant to the decision from which they appeal. The question of a covenant not-to-compete never arose since Dr. Prince never intended to compete with the Practice. Accordingly, the issue of the "ownership" of a non-existent covenant not-to-compete was never decided. As the Seventh Circuit observed, the extremely remote possibility of Dr. Prince leaving the Practice and competing elsewhere was a factor which could be taken into account in valuing the stock:

> On the day the plan was confirmed, Dr. Prince's leaving the competing with the corporation was hardly a 100 percent certainty. It was a possible event that affected the value of the stock: the higher the probability of him competing, the lower the expected future cash flows to the stock, and the lower the probability of him competing, the higher the expected future cash flows to the stock.

(App. at A-12) All parties to the Amended Plan assumed that Dr. Prince would not go out and compete against himself, despite the absence of a covenant not-to-compete and, thus, the possibility of Dr. Prince competing against the Practice could be discounted to zero:

> However, it is not clear that the probability of him leaving and competing was any higher than zero despite the absence of a covenant not to compete. At the time the plan was confirmed, Dr. Prince was operating the practice, and it seems quite unlikely that while still owning the stock he would have

> abandoned his practice, moved across the street, and competed with himself.

(Id.) To put it bluntly, the valuation of the stock is entirely independent of the existence of a covenant not-to-compete at the time of the plan because Dr. Prince intended to keep the corporation operating as a Professional Practice. Whether Dr. Prince could have abandoned his Practice prior to the time of the Amended Plan and compete with his former professional corporation, and whether the bankruptcy estate would have owned a restrictive covenant arising therefrom, may be interesting questions; they are questions, however, not presented by the facts of this case.

Since this case never presented the questions of "ownership" of covenants not-to-compete or of goodwill, the Petitioners' argument that there is a split of authority as to ownership of covenants not to compete can be ignored. The issue was not addressed by the Seventh Circuit and has never been part of this case. Accordingly, this question does not present adequate grounds for the granting of the Petition.

Moreover, the Petitioners are mistaken in asserting that there is a "split" among the circuits on this (irrelevant) question. Only the Fourth Circuit has addressed this issue, and the Fourth Circuit found that lower courts (save one) have consistently found such a covenant to be part of the bankruptcy estate. See In re Andrews, 80 F.3d 906, 911-12 (4th Cir. 1996). Thus, even if this question were relevant to this case (which it is not), there is no "split of authority" which would warrant review.

Further, the Petitioners' contention that the Seventh Circuit's decision ignored Illinois law holding goodwill to be a personal attribute misses the mark. The Petitioners have

failed to cite any authority for the proposition that professional goodwill cannot be valued as part of stock or transferred to another party. In fact, the one case the Petitioners do cite, In re Marriage of Zells, 143 Ill. 2d 251, 254, 572 N.E.2d 944, 946 (1991), recognizes that professional goodwill can be valued in divorce proceedings based upon a professional's ability to generate income.[3] This is precisely the manner in which goodwill was valued with respect to Dr. Prince's stock. (App. at A-16) The Seventh Circuit, in fact, went further: it noted a distinction between the "goodwill" which was a personal attribute of Dr. Prince and the "goodwill" which was inherent in the value of the Professional Practice. (Id. at A-16 - A-17) The former could not be transferred nor taken into account in valuing the stock:

> In an important sense, however, Dr. Prince's goodwill is unlike his skills, his schooling, or his dental license. These components of Dr. Prince's human capital can only manifest their value by increasing the worth of his future labors. Dr. Prince's innate physical ability, his personality, or his professional degree increased the market value of his services, but they cannot be sold to another orthodontist; they have value only as attributes of Dr. Prince.

(App. at 1-16) Thus, the Seventh Circuit recognized that

---

[3]In Zells, the Illinois Supreme Court held that professional goodwill should not be valued as a discrete marital asset, but rather as part of a spouse's income potential. Id., 572 N.E.2d at 946. The Zells decision does not state that a professional's good will is incapable of being transferred.

certain aspects of goodwill are, indeed, personal attributes and cannot be transferred. Other aspects of goodwill do have value apart from a person and can be transferred--as Dr. Prince recognized when he tried to sell the Practice and his goodwill to Dr. Clare. Accordingly, the Seventh Circuit properly took this type of transferrable goodwill into account when valuing the stock. This holding is consistent with Illinois law.

Finally, the Committee notes that under the Bankruptcy Code, as with all instances of the valuation of property, valuing is to be done on a case-by-case basis. The Seventh Circuit correctly applied the appropriate method of valuing the Debtors' stock in this case. There are no compelling reasons why the Seventh Circuit's decision should be reviewed or overturned in this case, nor does this case present issues of such overriding concern that review is necessary to establish precedents for use in other cases. Accordingly, the Committee submits that this case does not constitute an appropriate matter for this Court's review.

CONCLUSION

The sole question presented by this case is the proper valuation method for Dr. Prince's stock. The decision on review correctly valued that stock on a going-concern basis, based on the purpose for which the stock was being valued and the debtor's intended use after confirmation. This method is the generally accepted method for valuing stock and is consistent with the approach set forth in the Bankruptcy Code for valuing assets. On this issue, the only issue in this case, there is no split of authority. The Petitioners have failed to demonstrate that the stock should

be valued in a different manner. Rather, the Petitioners have focused on questions which are not germane to the facts of this case. No compelling reasons have been presented for granting a writ of certiorari in this matter and, accordingly, the Petition should be denied.

Respectfully submitted,

Daniel A. Zazove
Counsel of Record for Respondent
Barbakoff Zazove & Glick Chartered
20 N. Clark St., Suite #1000
Chicago, IL 60602
312 641-1155

Of Counsel:
Barbara L. Yong
Peter J. Butler
Barbakoff Zazove & Glick Chartered
20 North Clark Street, Suite 1000
Chicago, Illinois 60602
(312) 641-1155

SUPPLEMENTAL APPENDIX

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	
	)	
DOUGLAS R. PRINCE and JANE PRINCE,	)	**Case No. 94 C 3341**
	)	
	)	
Debtors.	)	**Judge Suzanne B. Conlon**

MEMORANDUM OPINION AND ORDER

A bankruptcy judge entered a final order valuing Douglas Prince's ("Dr. Prince") Illinois orthodontic practice at $405,000. Debtors Douglas and Jane Prince appeal the judgment to this court. 28 U.S.C. § 1334 (a).

BACKGROUND

The essential facts are undisputed. Dr. Prince is an orthodontist who filed Chapter 11 bankruptcy with his wife on August 17, 1981. On November 7, 1983, the bankruptcy court approved a reorganization plan under which the Princes were to sell certain assets. The plan allowed Dr. Prince to retain his orthodontic practice, but he was required to pay creditors the value of the practice over a period of years. If Dr. Prince and the unsecured creditors' committee (the "creditors' committee") did not agree on a value for the practice, the plan provided that the value would be determined by a bankruptcy court after a hearing.

On February 25, 1984, Dr. Prince agreed to sell his orthodontic practice to Dr. Timothy Clare, an orthodontist from New York. Dr. Prince neither informed the creditors'

committee of the sale nor told Dr. Clare that he was in bankruptcy, although both parties soon discovered the respective information. Dr. Clare was to begin making payments in September 1984. Between February 25 and September 4 (the "interim period"), Dr. Prince agreed to work at the practice several weeks per month, to be responsible for all debts of the practice, and to pay Dr. Clare a salary of $500 for each day Dr. Clare worked in Dr. Prince's office. Arm's length negotiations between Dr. Prince and Dr. Clare resulted in a contract price of $450,000 for sale of the practice.

Dr. Prince, however, used a different method of valuation in his negotiations with the creditors' committee. Dr. Prince maintained to the committee that the only value of the practice after he left were its tangible assets, or $7,500. The committee sought a valuation of $450,000. After a trial on the issue, the bankruptcy court determined that the value of the practice was $7,500 exclusive of goodwill, which the court held was an inappropriate factor to be used in valuation. The creditors' committee appealed the finding; a district court reversed the bankruptcy court's decision and remanded for a valuation that included goodwill.

Upon remand, the creditors' committee moved for summary judgment on a valuation of $395,769.23, representing the difference between the contract price and the value of Dr. Prince's "transitional services" during the interim period. On August 7, 1993, the bankruptcy court granted summary judgment. The Princes appealed; a district court again remanded the case, this time to adduce additional evidence.

On October 21, 1993, the bankruptcy court reopened the valuation hearing. The court accepted various forms of

evidence, including testimony by Dr. Prince and Dr. Clare that the $450,000 contract price overstated the value of the practice. The bankruptcy court then closed the proofs and heard final arguments. The Princes argued that the valuation of the practice should be offset by salary, housing, transportation, and other benefits paid by Dr. Prince to Dr. Clare during the interim period in which Dr. Prince acclimated Dr. Clare to the practice. During this argument, it dawned upon all three parties that a crucial issue was whether Dr. Prince or Dr. Clare received the income from the orthodontic practice during the interim period. Oct. 21, 1993 Transcript ("Tr.") 147. The parties and the court agreed that if Dr. Clare received the income from the practice during the interim period, then Dr. Prince would be entitled to an offset for the value of his services. If, however, Dr. Prince received the income, an offset would be improper. Rather than "leav[ing] this as an open issue," the bankruptcy court, without adjourning, recalled Dr. Prince to testify as to which doctor received the income from the practice until September 4. Dr. Prince testified that Dr. Clare received the income. Believing that this contradicted the apparent intent of the written contract, the court noted that Dr. Clare was to be paid $500 per day in salary and that Dr. Prince remained responsible for rent until September 4. Oct. 21, 1993 Tr. 153. Nevertheless, Dr. Prince maintained that Dr. Clare received the income, and Dr. Prince's counsel admonished the court not to "second-guess" the parties' actions. Oct. 21, 1993 Tr. 154. The creditors' committee objected that Dr. Prince's testimony did not comport with the apparent intent of the contract. However, the bankruptcy court, having no other evidence, resolved the issue with some hesitancy:

> All right. I guess the best I am going to have on this is the testimony I have heard. I think it's somewhat at odds with the apparent intent

> of this document. But on the other hand, I don't have any testimony to refute what you are saying, Dr. Prince. So I am going to accept that. I will accept that Dr. Clare received the income from this enterprise from the September [sic] 25 date forward. It's the best evidence I have at this point.

Tr. 157.[1]

The bankruptcy court concluded that the $450,000 practice valuation would be reduced by the value of Dr. Prince's services, as well as the salary, housing, transportation, fuel, and insurance for Dr. Clare. The net value of the practice was set at $292,290.

Within ten days after entry of the judgment, the creditors' committee moved to alter the judgment or, in the alternative, to reopen the proofs and take additional evidence. R. 8. In support of its motion, the creditors' committee directed the bankruptcy court to provisions of the sales contract, a handwritten letter from Dr. Prince to Dr. Clare, deposition testimony given by Dr. Prince in 1984, Dr. Clare's testimony at the original valuation hearing in 1988, and Dr. Clare's 1984 deposition testimony. R. 8; R. 11, p. 5. These proffers contradicted Dr. Prince's testimony that Dr. Clare received the income from the orthodontic practice during the interim period. Faced with conflicting evidence, the court, before ruling on the motion, granted the creditors' committee leave to obtain bank records maintained in the

---

[1]The reference to "September 25" appears to be an error. The bankruptcy court probably meant "February 25," the effective date of the sale contract for the orthodontic practice.

name of the orthodontic practice. R. 11, p. 6. After reviewing the records, the bankruptcy court granted the motion of the creditors' committee to alter the judgment, finding it "undisputed that the bank records confirm that Dr. Prince and not Dr. Clare received the income of the Professional Practice for the months of February, March, April, May, and June of 1984, after which time neither Dr. Prince nor Dr. Clare continued to operate the Professional Practice." R. 11, p. 6. The bankruptcy court then adjusted its previous deductions, arrived at a valuation of $405,440 inclusive of goodwill, and entered a final order.

In this appeal, the Princes argue that the bankruptcy court abused its discretion by granting the motion of the creditors' committee to amend the October 21, 1993 valuation finding.

DISCUSSION

The sole issue on appeal is whether the bankruptcy court properly granted the motion of the creditors' committee to alter judgment under Fed. R. Civ. P. 59. A grant or denial of a Rule 59 motion is reviewed for abuse of discretion. Souter v. International Union. United Auto. etc., Local 72, 993 F.2d 595, 599 (7th Cir. 1993). Rule 59 motions are generally used to correct a manifest error of law or fact, or to consider newly discovered evidence that could change the result of a proceeding. Souter, 993 F.2d at 599; Federal Deposit Ins. Corp. v. Meyer, 781 F.2d 1260, 1268 (7th Cir. 1986). These factors, however, are not themselves dispositive. Rather, they are animated by the court's duty to ensure substantial justice, and are markers designed to alert the court when justice is likely to be compromised. See 11 C. Wright & A. Miller, Federal Prac. & Procedure, § 2803 (1973 & Supp. 1994); Guinan v. United States, 6 F.3d 468,

470 (7th Cir. 1993); Juneau Square Corp. v. First Wis. Nat'l Bank, 624 F.2d 798, 806 n.11 (7th Cir. 1980); cf. Fryman v. Federal Crop Ins. Corp., 936 F.2d 244, 251 (6th Cir. 1991). Thus, when a Rule 59 motion is denied despite newly discovered evidence or a manifest error of law or fact, the losing party has an argument for abuse of discretion because the new evidence or articulation of error suggests that justice may have been compromised. On the other hand, a party appealing the grant of a Rule 59 motion because the prevailing party was able to convince the court that the result was unjust, albeit without the benefit of newly discovered evidence or manifest error, has a more difficult burden. The ultimate question is whether the court, in its discretion, believes that injustice has somehow infected the judgment.

The Princes make only one argument: The bankruptcy court abused its discretion in opening the judgment because the creditors' committee could have obtained the bank records prior to the October 21, 1993 hearing and avoided Dr. Prince's "erroneous" testimony. One problem with this argument is that the Princes themselves could have obtained the bank records prior to the hearing and avoided Dr. Prince's "erroneous" testimony. The fact that the records were not produced during the hearing confirms that neither party understood that the income stream would be an issue. Only during final argument colloquy did the parties realize the importance of the issue. This left the Princes with an advantage because only they had a ready source of evidence to address the issue: Dr. Prince. Dr. Prince's testimony was wrong. Any attempt by the Princes to uphold this false testimony in light of "undisputed" proof to the contrary must be rejected.

In any event, the Princes' argument misses a more fundamental point. Although the bankruptcy court did not

elaborate on its reasons for altering judgment beyond opining that it would be "inappropriate" to bar the creditors' committee from showing that Dr. Prince 's testimony was patently false, it is reasonable to infer that the bankruptcy court granted the motion of the creditors' committee in the interest of justice. Neither the committee nor the Princes presented evidence at the October 21, 1993 hearing as to which doctor received the income from the practice during the interim period. The creditors' committee, the Princes, and the bankruptcy court realized that this issue was important only during closing arguments and after the proofs were closed. R. 11, p. 3-4. Because the bankruptcy court could not accurately value the practice without an answer to the income stream question, the court reopened the proofs for the limited purpose of allowing Dr. Prince, who happened to be present, to testify on the issue. R. 11, p. 4. Dr. Prince testified that Dr. Clare received the income. Over objection of the creditors' committee, the court accepted Dr. Prince's testimony despite its own misgivings. Tr. 157. Within days of the hearing, the creditors' committee sifted through voluminous documents and other information accumulated throughout this litigation's 14-year life and discovered several pieces of evidence that cast doubt on Dr. Prince's income-stream testimony. In light of this evidence, the bankruptcy court directed the creditors' committee to obtain bank records to resolve the issue conclusively. The bank records confirmed that Dr. Prince received the income during the interim period. The bankruptcy court then admitted the bank records into evidence and adjusted its valuation to reflect that Dr. Prince and not Dr. Clare had received the income.

The Princes objected to this action, and the bankruptcy court therefore was presented with a choice. It could reopen the proofs and reach a correct result or it could

knowingly enter an erroneous judgment giving Dr. Prince a $105,000 windfall as a result of his own false testimony. The bankruptcy court did not abuse its discretion by choosing the first option.

Aside from this "interest of justice" rationale, the bankruptcy court's action was proper in two other respects as well. First, the bankruptcy court's decision to admit the bank records into evidence corrected a manifest error of fact. Rule 59 motions are properly used to correct manifest errors of fact. Souter, 993 F.2d at 599. Likewise, a court may grant a new trial or otherwise alter a judgment if that judgment is based on false testimony. See Antevski v. Volkswagenwerk Aktiengesellachaft, 4 F.3d 537, 540 (7th Cir. 1993). Both of these tenets apply in this case. Here, the creditors' committee made a substantial proffer that Dr. Prince received the income from the practice, and bank records later demonstrated that fact conclusively. This evidence put the bankruptcy court on notice that it had made a factual error by finding that Dr. Clare received the income. Similarly, the motion of the creditors' committee alerted the bankruptcy court that Dr. Prince, whether by accident or design, had given factually inaccurate testimony. Because the bankruptcy court relied heavily on this testimony to value the practice, it did not abuse its discretion by opening the judgment to correct its error.

Finally, the bankruptcy court's action was sanctioned by Rule 59(a). The motion of the creditors' committee to alter the judgment alternatively asked the bankruptcy court to reopen the proofs and take additional evidence. In effect, the motion alternatively asked for a new trial on the income-stream issue. Rule 59(a) provides:

> On a motion for a new trial in an action tried without a jury, the court may open the judgment if one has been entered, take additional testimony, amend findings of fact and conclusions of law or make new findings and conclusions, and direct entry of a new judgment.

Because the valuation hearing was tried without a jury, the court was empowered to grant a new trial on any aspect of the issues "for any of the reasons for which rehearings have heretofore been granted in suits in equity in the courts of the United States." F.R.C.P. 59(a). The bankruptcy court's decision to admit the bank records into evidence may properly be viewed as granting the Rule 59(a) motion of the creditors' committee. The bankruptcy court considered the new evidence and modified its conclusions of fact accordingly. Moreover, the Princes were not prejudiced. The bankruptcy court offered them an opportunity to contest the authenticity and interpretation of the bank records at a March 17, 1994 hearing. See March 17, 1994 Tr. 2-20.

Thus, whether the bankruptcy court modified the valuation to correct a manifest error of fact, because the valuation was based on false testimony, or because justice required the modification, the bankruptcy court did not abuse its discretion by revaluing Dr. Prince's enterprise.

CONCLUSION

The judgment of the bankruptcy court is affirmed.

ENTERED:

/s/ Suzanne B. Conlon
Suzanne B. Conlon
United States District Judge

September 1, 1994

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re	)	**Chapter 11**
	)	
DOUGLAS R. PRINCE	)	**Case No. 81 B 09964**
and JANE PRINCE,	)	
	)	
Debtors.	)	**Hon. Eugene R. Wedoff**

ORDER GRANTING THE MOTION
OF THE UNSECURED CREDITORS' COMMITTEE
TO ALTER OR AMEND JUDGMENT

This matter was heard by the court on the motion of the Unsecured Creditors' Committee (the "Committee") to alter or amend the judgment of this court dated November 18, 1993 which order determined the value of the professional orthodontic practice of Douglas R. Prince ("Dr. Prince") to be in the amount of $292,290, inclusive of Dr. Prince's goodwill. The court makes the following findings:

1. On August 17, 1981, Douglas R. and Jane Prince (the "Princes"), as husband and wife, filed their joint petition for relief under chapter 11 of the Bankruptcy Code.

2. At the date of the filing initiating the bankruptcy case, Dr. Prince was the owner of a professional orthodontic practice operated under the name of Douglas R. Prince D.D.S., M.S., Ltd. (the "Professional Practice" or "Practice").

3. On November 7, 1983, the Princes' Amended Plan of Reorganization (the "Plan") was confirmed by this court.

4. The Plan provides, in part, for the Princes to turn over certain assets to a liquidating and disbursing agent for sale or disposition.

5. The Plan also provides for the Princes to retain certain other assets, including the stock of the Professional Practice and to pay their creditors the value of the retained assets over a period of years. The Plan is silent as to the method to be used to determine the value of the Professional Practice, but does provide for the court to resolve valuation disputes in the event Dr. Prince and the Committee are unable to agree.

6. On February 25, 1984, Dr. Prince and another orthodontist, Dr. Timothy J. Clare ("Dr. Clare"), of Orchard Park, New York, entered into an agreement for the purchase and sale of the Professional Practice ("Practice Sales Contract"), inclusive of its going concern value, for a then present value price of $450,000, paid by Dr. Clare to Dr. Prince. Apparently, neither the buyer nor the seller consulted with counsel prior to signing the agreement.

7. Subsequent to the signing of the Practice Sales Contract, Dr. Prince and Dr. Clare had a falling out, described in Prince v. Zazove, 959 F.2d 1395 (7th Cir. 1992).

8. Because Dr. Prince and the Committee were unable to agree on the value for the Professional Practice, they submitted the valuation issue for trial before the bankruptcy court. At the conclusion of the trial, this court determined as a matter of law that the value of the

Professional Practice was $7,500, not including the personal goodwill of Dr. Prince, based upon the net liquidation value of the tangible assets.

9. The Committee appealed the valuation determination to the United States District court. On April 12, 1993, District Court Judge John F. Grady reversed the bankruptcy court's decision insofar as it excluded goodwill from the valuation and remanded the case back to this court for a determination of the value of the Professional Practice with goodwill included by reference to the Practice Sales Contract. (127 B.R. 187 (N.D. Ill. 1991).)

10. After remand, the Committee filed a motion for summary judgment in which it stipulated that the value of the Professional Practice, solely for the purpose of the motion, was $395,769.23, representing the difference between $450,000 and value of Dr. Prince's transitional services under the Practice Sales Contract. The Princes contested the Committee's motion and offered certain affidavits and interrogatory answers filed by Dr. Clare in opposition.

11. On August 7, 1993, the bankruptcy court granted the Committee's summary judgment; and the Princes appealed.

12. At the request of the Committee, the Princes' appeal was reassigned to Judge John F. Grady, who reversed the order granting summary judgment and remanded the case back to the bankruptcy court.

13. On October 21, 1993, this court reopened the trial on the valuation of the Professional Practice to take additional evidence pursuant to the mandate of the district court.

14. The Princes presented the testimony of both Dr. Prince and Dr. Clare in support of their contention that the Practice value was less than the $450,000 value stated in the Practice Sales Contract.

15. However, neither the Princes nor the Committee offered any evidence as to whether Dr. Prince or Dr. Clare was entitled to the income generated by the Professional Practice between the date of the signing of the Practice Sales Contract on February 25, 1984 until September 20, 1984, the date when Dr. Clare was to commence making installment payments to Dr. Prince as set in the Contract (the "Interim Period").

16. During post hearing argument after the proofs were closed, the Princes argued that the value of the Practice should be reduced by the value of personal services provided by Dr. Prince to the Practice during the Interim Period, by the value of certain benefits provided to Dr. Clare (car, house etc.) during the Interim Period, and by the salary paid to Dr. Clare during the Interim Period. The Princes advanced the theory that the amount of these obligations, which were set forth in the Practice Sales Contract, reduced the consideration to be paid to Dr. Prince by Dr. Clare.

17. This court determined that Dr. Prince's arguments could not be properly evaluated unless it was established whether Dr. Prince or Dr. Clare actually received the income from the Practice during the Interim Period. This court concluded that if Dr. Prince received the income and used it to pay these obligations under the Practice Sales Contract, a setoff might not be in order; however, if Dr. Clare received the income, then Dr. Prince's personal obligation to make these payments from his own assets and personally perform services would be an offset against the

purchase price. Thereupon, this court reopened the proofs solely to allow Dr. Prince to testify as to whether he or Dr. Clare was entitled to the income generated by the Professional Practice between February 25, 1984 and September, 1984. Dr. Prince testified that it was Dr. Clare who was entitled to the Professional Practice income during this period.

18. After considering Dr. Princes's testimony on this point, this court found that Dr. Clare was entitled to the revenue for the Professional Practice during the Interim Period. Therefore, the court further determined that the value of Dr. Prince's services and the payments made by Dr. Prince for Dr. Clare's salary and expenses reduced the amount to be paid to Dr. Prince by Dr. Clare under the Practice Sales Contract and accordingly reduced the value of the Professional Practice.

19. Specifically, this court ruled on October 21, 1993 that the $450,000 value of the Professional Practice was to be reduced by the following:

a. $112,500 for the value of Dr. Prince's services, to be rendered after signing of the Practice Sales Agreement;

b. $7,200 for housing provided to Dr. Clare;

c. $360 for gasoline provided for Dr. Clare;

d. $7,000 for travel expenses allowed to Dr. Clare;

e. $650 for payment of professional liability insurance for Dr. Clare; and

f. $30,000 of salary paid to Dr. Clare.

20. On November 9, 1993, the Committee moved to alter this court's October 21, 1993 ruling, insofar as the determination of value deducted the amounts enumerated in paragraph 19 above. In support of its motion, the Committee directed the court's attention to specific provisions of the Practice Sales Contract itself, to a hand-written letter from Dr. Prince to Dr. Clare, to Dr. Prince's deposition taken in Prince v. Clare, 84 C 7694, to Dr. Clare's testimony at the original valuation hearing held on November 10, 1988, and to the transcript of Dr. Clare's deposition taken in Prince v. Clare, 84 C 7694. Alternatively, the Committee requested that if this court was not inclined to alter or amend the judgment, that it reopen proofs, to take the additional evidence offered by the Committee on this point.

21. The Princes objected to the Committee's motion to alter the judgment, arguing that the court should not consider the additional evidence offered by the Committee in the Motion to Alter. However, it would be inappropriate to refuse to reconsider the matter and other relevant and probative evidence on the issue of whether Dr. Clare or Dr. Prince received the income from the Professional Practice after signing of the Practice Sales Contract. Accordingly, this court offered the Committee the opportunity to obtain relevant bank records to establish conclusively, in the face of conflicting testimony on the point in the record, whether Dr. Prince or Dr. Clare received the income from the Professional Practice after signing the Practice Sales Contract.

22. Based upon the court's direction, the Committee obtained the bank records from an account maintained in the name of the Professional Practice at the Bank of Naperville for the period in question. The parties have reviewed these records and it is undisputed that the bank records confirm that Dr. Prince and not Dr. Clare received the income of the Professional Practice for the months of February, March, April, May and June of 1984, after which time neither Dr. Prince nor Dr. Clare continued to operate the Professional Practice.

23. Based upon these records, all of the other evidence presented by the Committee on the point, and the additional evidence offered by Dr. Prince at a subsequent hearing held on April 1, 1994, this court concludes as follows:

a. That the Practice Sales Contract was signed by the parties on February 25, 1984, and the Professional Practice was to remain in the name of and operated for the benefit of Dr. Prince until a closing on the transfer, on September 4, 1984.

b. That the amount of $450,000 was the value of the Professional Practice fixed by Dr. Clare and Dr. Prince in arms length negotiations, which amount was considered by them to be the value of the Practice on September 4, 1984.

c. That the total net amount to be paid by Dr. Clare to Dr. Prince, pursuant to the Practice Sales Contract, was $450,000.

d. That, during the period from February 25, 1984 until September 4, 1984, pursuant to the Practice Sales Contract, Dr. Prince was to receive for his own benefit the income generated by the operation of the Professional Practice.

e. The Practice Sales Contract contemplates that the amount actually received by Dr. Prince for the sale of the Professional Practice to Dr. Clare would be reduced by the following amounts:

(1) $30,000 of salary to be paid to Dr. Clare;

(2) $7,200 for the value of Dr. Clare's housing;

(3) $7,000 for travel expenses of Dr. Clare; and

(4) $360 for gasoline expenses for Dr. Clare's vehicle.

Total **$44,560**

24. Based upon these findings, and the applicable law, this court therefore grants the Committee's Motion To Alter Judgment. Based upon the record of this case and the applicable law, this court determines that the value of the Professional Practice, for purposes of this proceeding and the Amended Plan of Reorganization, is $405,440, inclusive of goodwill.

25. This is a final order of the Bankruptcy Court which determines all remaining valuation issues.

BY THE COURT:

/s/ Eugene R. Wedoff
UNITED STATES BANKRUPTCY JUDGE

Dated: 4/12/94 Effective 4/14/94

Daniel A. Zazove
Norman P. Jeddeloh
Siegan Barbakoff Gomberg & Kane, Ltd.
20 N. Clark St., #1000
Chicago, IL 60602
312/641-1155